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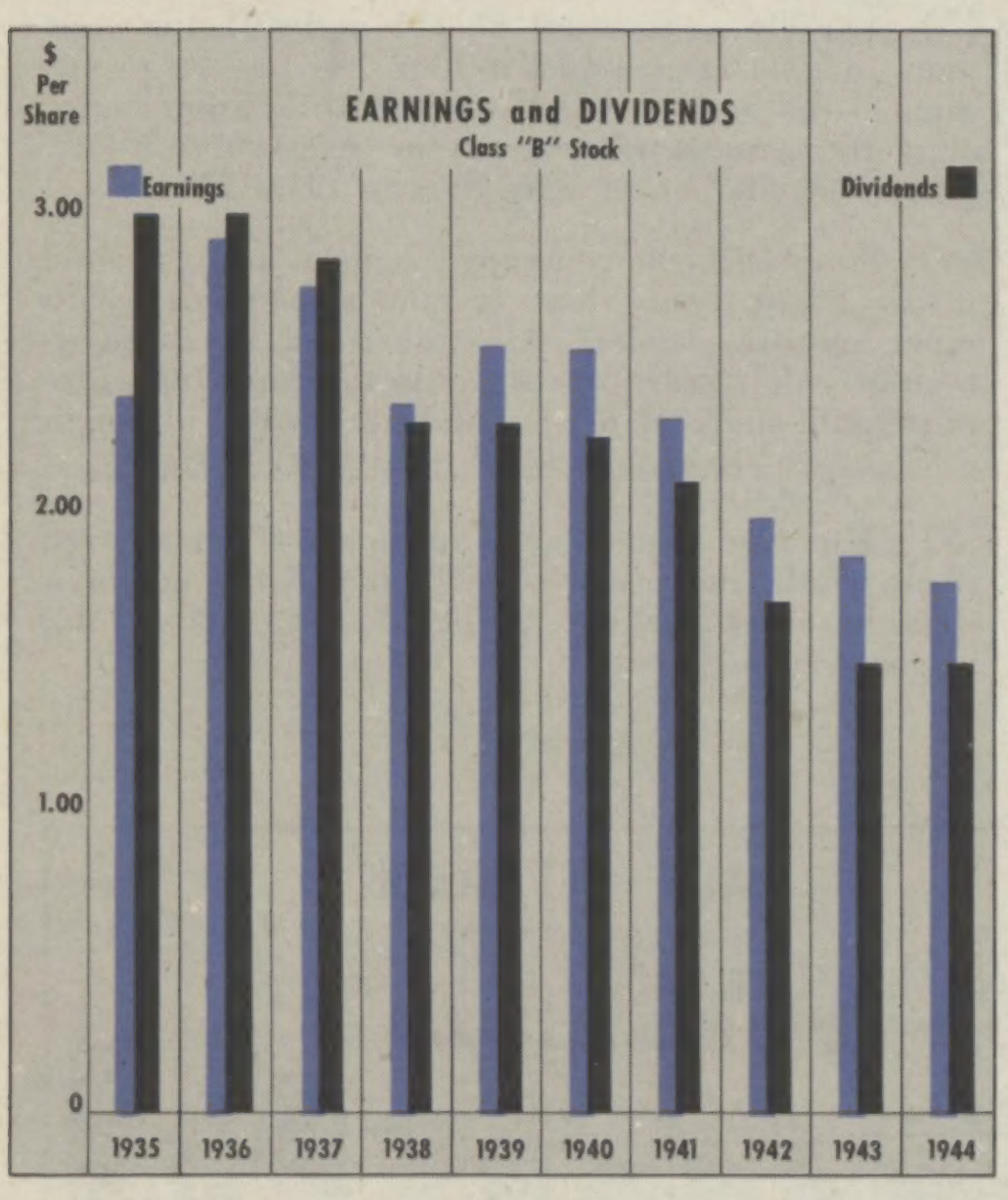
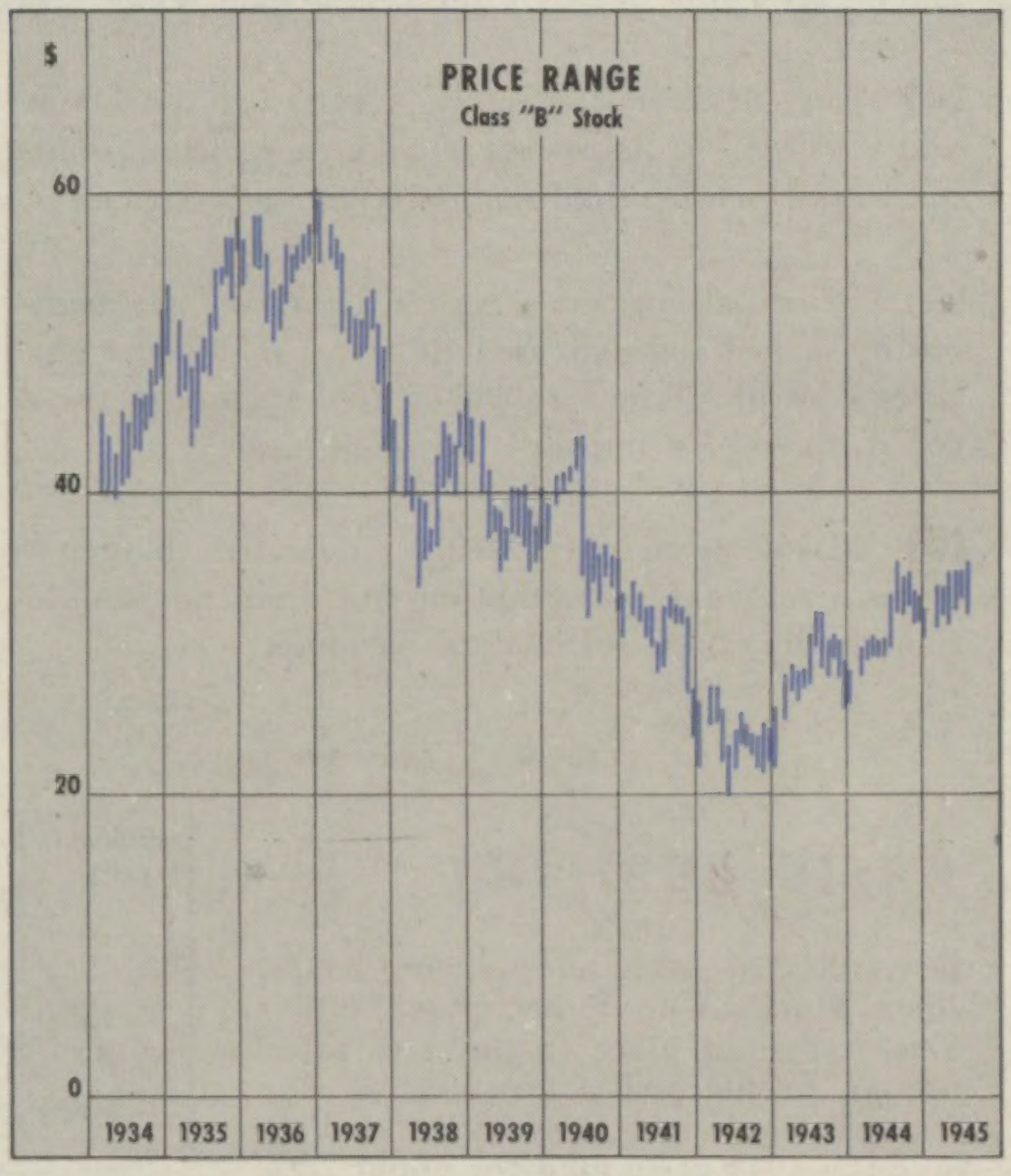
R. J. REYNOLDS TOBACCO COMPANY





TIMING . . . For every investor, sound investment procedure requires a series of separate but related decisions in each of which "risks and rewards" must be weighed. Of these decisions, all investment experience proves that "when to buy" ranks equally in importance with "what to buy." Similarly, the alert investor will recognize that there is no security which can be "bought and forgotten" and that successful investment requires keen judgment in timing sales as well as purchases.

MERRILL LYNCH, PIERCE, FENNER & BEANE

Underwriters and Distributors of Investment Securities
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R. J. REYNOLDS TOBACCO COMPANY

FAVORABLE

(1) The company is a leading factor in an industry with at least demonstrated stability and some growth characteristics.

(2) The war-stimulated demand for cigarettes may endure after this war as it did after World War I.

(3) Current year may mark a turn for the better and a reversal of the recent trend of narrowing profit-margins which resulted mainly from war restrictions.

(4) Principal current earnings deterrents are availability of leaf tobacco, availability of manpower and price controls. A betterment of one or more of these could materially improve earnings results.

(5) Maintenance of currently indicated dividends seems a reasonable assumption and dividends should remain liberal in relation to earnings.

UNFAVORABLE

(1) Restrictions on leaf tobacco have prevented the company from satisfying the civilian demand.

(2) In 1944 25% of cigarette sales were to the Armed Forces at prices averaging about 5½% below civilian prices.

(3) Largely as a result of (1) and (2) the company in 1944 earned $2.3 million less pre-tax profits than in the base period 1936-1939 while other major cigarette manufacturers last year made substantially greater profits before taxes than in 1936-1939.

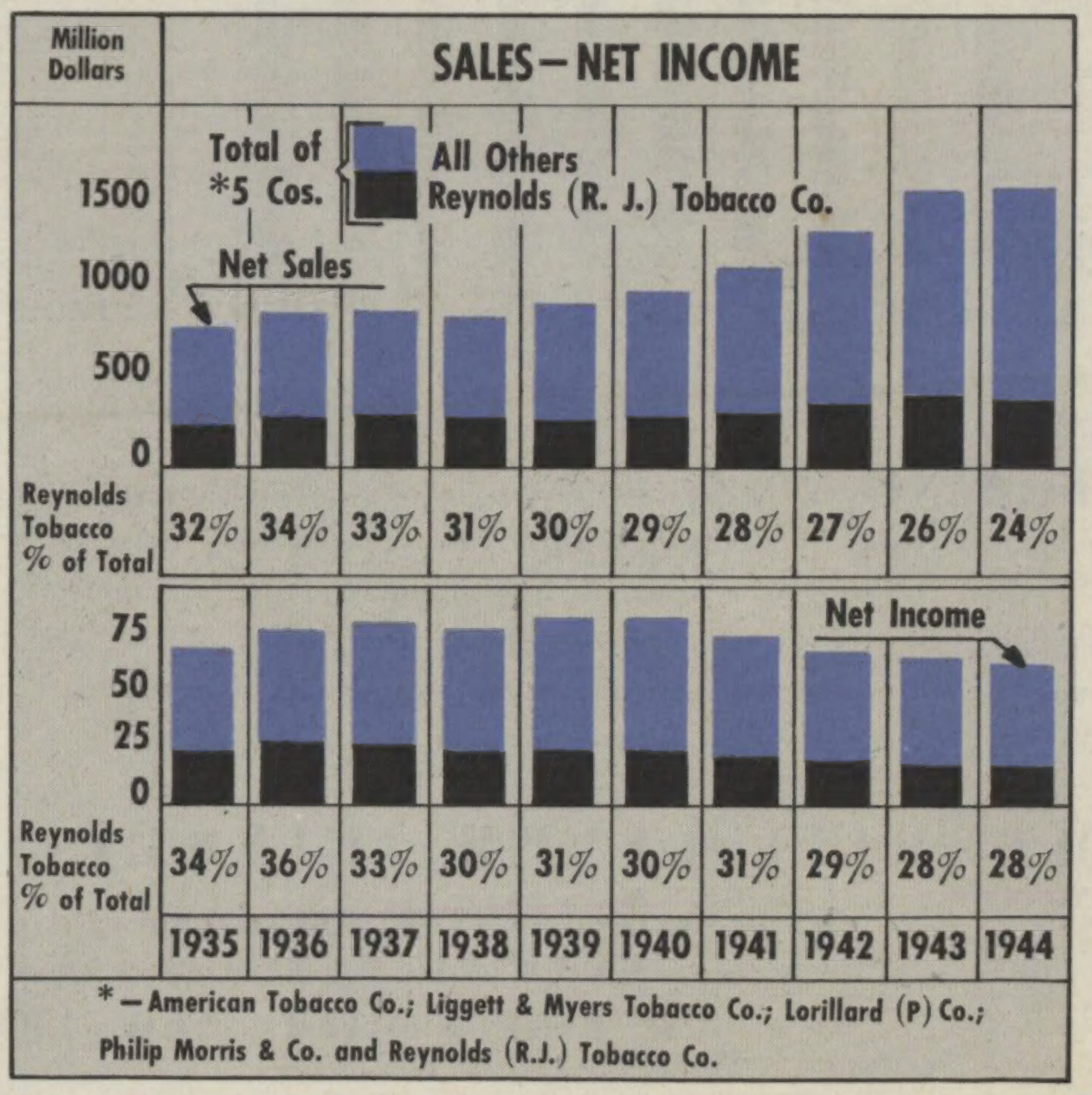
(4) Since 1936 the company has been losing ground in its proportionate share of sales as compared with other industry leaders. Also the trend has been irregularly downward in respect to the company's proportionate share of pre-tax and net profits, although there was a slight turn for the better in 1944.

(5) The new issue of $49 million 3.6% preferred stock would increase charges prior to the common stock by a net of about 13¢ per share if earnings are not subject to Excess Profits Taxes.

BASIC POSITION

Reynolds has been an industry leader since World War I, occupying either first or second place in point of sales, pre-tax profits and net profits. Of the five principal cigarette companies, Reynolds in 1944 accounted for about 24% of sales, 25% of pre-tax profits and 28% of net profits, standing second in all three categories.

Concentration of substantially all facilities in the world's largest tobacco manufacturing plant at Winston-Salem, North Carolina, and concentration of management at the plant make this company unique in the industry in these two respects. This concentration of physical facilities and management enabled the company to exercise executive direction and dictate its own policies independently even during the period 1899-1911 when the "Tobacco Trust" owned a two-thirds interest. After the dissolution of the "Trust" in 1911, founder R. J. Reynolds lost no time in putting into effect his then revolutionary ideas of a national brand of cigarette, nationally advertised. In those



days brand names were transitory and manufacturers were giving away premiums and using other haphazard methods for promoting sales. The advent of the CAMEL Cigarettes in 1913 in a handy package and with emphasis on quality and blend revolutionized the American cigarette industry. The blend was (and still is) a combination of domestic bright and burley tobaccos and those original CAMEL packages carried the legend (and still do) "Don't look for premiums or coupons, as the cost of the tobaccos blended in CAMEL Cigarettes prohibits the use of them."

Of the best known brands of the company, CAMEL Cigarettes (an estimated 68.3 billion sold in 1944, or 21.2% of estimated industry total) are the most important single item in point of sales and profits. Well over 75% of the company's sales, pre-tax profits and net income can reasonably be estimated to come from CAMEL Cigarettes alone. The balance of sales is represented by such well-known brands as "Prince Albert" and "Our Advertiser" (smoking tobaccos), "Brown's Mule", "Apple" and "Honey Cut" (chewing tobaccos) and "Stud" and "Top" (cigarette tobaccos). Dollar sales are divided approximately as follows: cigarettes, 86.6%; smoking tobacco, 7.7%; chewing tobacco, 4.8%; miscellaneous, 0.9%.

CAPITALIZATION—DECEMBER 31, 1944

1¾% Serial Notes due 1946-1949	$8,000,000
Common Stock ($10 par)	1,000,000 shares
Class "B" Stock ($10 par common non-voting)	9,000,000 shares

COMMENT: Capitalization has long consisted mainly of two classes of capital stock. Only occasionally have current borrowings to finance enlarged inventories been funded into long-term debt. Issuance of $49 million 3.6% preferred after approval by stockholders at a meeting on June 26, 1945, substituted senior capital for bank borrowings to finance inventories and created a senior dividend requirement ahead of the common and Class "B" stocks which would have absorbed about 7½% of earnings available for dividends on all classes of stock in 1944 after taking into account estimated savings in interest. The common stock commands a premium over the Class "B" stock because of the employee profit-sharing feature in connection with the common stock when owned by an employee.

EARNINGS

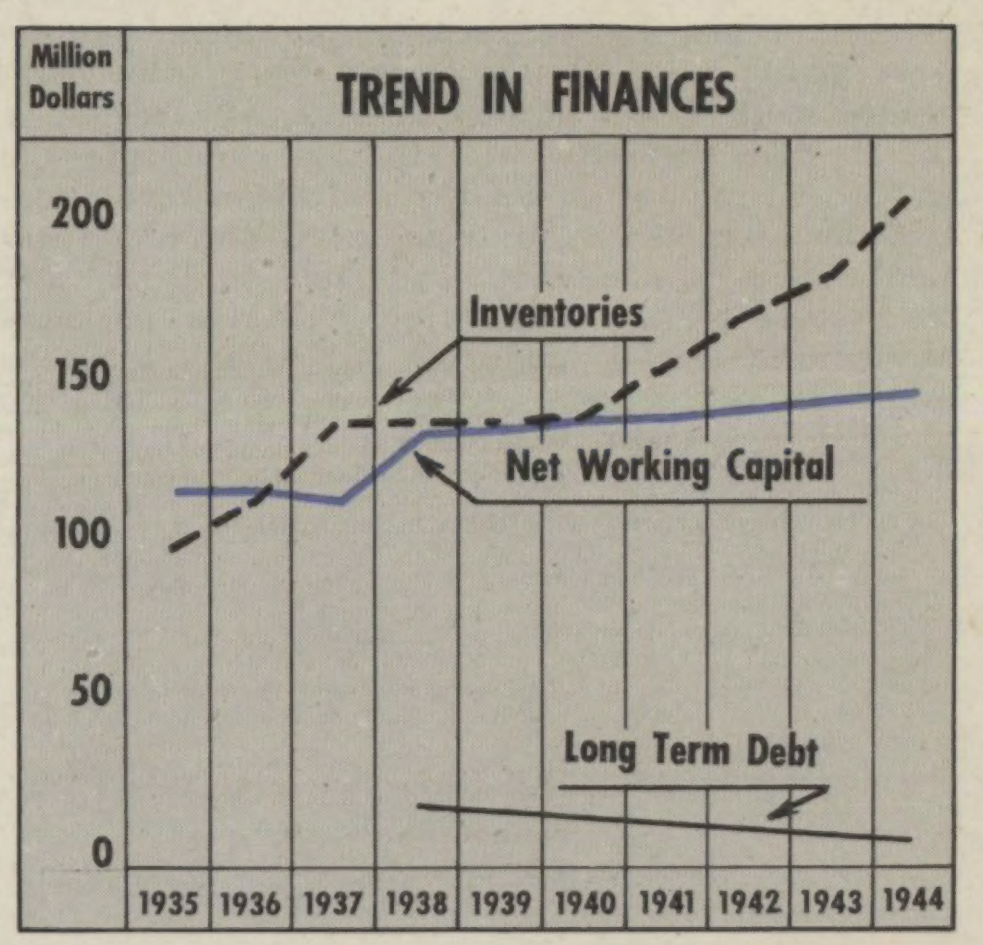
Sales of CAMEL Cigarettes in 1944 reached new peaks to an estimated 68.3 billion versus 67.2 billion in 1943 but dollar sales were down to $388 million from $414 million due to the larger proportion (25%) of production which went to the Armed Forces and on which the Internal Revenue Tax ($3.50 per thousand in the case of cigarettes) is not included in sales figures. Higher costs, including cost of leaf tobaccos and the fact that the Armed Forces paid for cigarettes in 1944 about 5½% under the civilian price, resulted in a decline in pre-tax profits from $36.3 million to $32.1 million. Because the latter figure was below the excess profits tax exemption base of about $33.2 million ($1.80 per common share after allowing for 40% taxes and the profit-sharing plan) net earnings were bolstered by a "carry-back" claim of $629,744 to a total of $17.8 million versus $18.6 million in 1943. Sales for the first quarter of 1945 were reported ahead of 1944 and net earnings about the same. Of cigarette sales, 53% went to the Armed Forces.

Years Ended Dec. 31	Net Sales	Deprec. & Obsoles.	Net Oper. Income	Net Oper. Margin of Profit	Fed. Inc. & Ex. Prof. Taxes	Net Income	Net Inc. % of Sales	$ Per Common Share: Fed. Inc. & Ex. Prof. Taxes	Earned	Divd.	Price Range Common High	Price Range Common Low	Price Range "B" High	Price Range "B" Low
	Dollar Figures in Thousands													
1944	$387,998	$ 962	$32,973	8.5%	$12,642	$17,818†	4.6%†	1.26	1.78†	1.50	35⅞		28	
1943	414,264	1,041	36,757	8.9	15,853	18,563	4.5	1.59	1.86	1.50	32¼		25¼	
1942	369,212	1,072	43,902	11.9	21,492	19,860	5.4	2.15	1.99	1.70	27½		20	
1941	323,020	1,061	41,123	12.7	16,359	23,239	7.2	1.64	2.32	2.10	34¼		22⅛	
1940	292,039	1,029	36,620	12.5	8,953	25,548	8.7	0.90	2.55	2.25	44		30½	
1939	276,730	1,188	33,508	12.1	5,800	25,645	9.3	0.58	2.56	2.30	45		35	
1938	282,265	1,142	30,505	10.8	5,058	23,734	8.4	0.51	2.37	2.30	46½		33¾	
1937	302,999	1,040	35,419	11.7	5,404	27,602	9.1	0.54	2.76	2.85	58		40¼	
1936	289,313	998	36,457	12.6	6,141	29,253	10.1	0.61	2.92	3.00	60½		50	
1935	250,636	933	28,476	11.4	5,697*	23,896	9.5	0.57*	2.39	3.00	58⅝		43⅛	

*—Includes state income taxes, not separately reported. †—After contingency reserve equal to $0.05 per share.

FINANCES

Although dividend policies have been relatively liberal, the management has long maintained the company in strong financial circumstances. In the past decade, net property account increased from $15.6 million to $15.9 million and net working capital rose from $117.9 million to $148.2 million. The latter figure is equal, after deducting senior securities, to $14.02 per share of capital stock. The only change in capitalization during this period was a relatively moderate increase in long-term debt from nothing in 1935 to $8 million in 1944. In the past decade dollar value of inventories rose from $98.7 million to $208.4 million which has necessitated borrowing from banks (current notes payable $67.5 million on December 31, 1944). At a special meeting on June 26, 1945, stockholders approved authorization of $75 million preferred stock of which $49 million was offered to holders of the combined classes of common stock on the basis of 1 share preferred at $100 for each 20 shares of common or Class "B" held, the issue having been underwritten. The management thereby replaced a substantial part of its current borrowing for capital requirements with a preferred stock at relatively low cost. The employees' profit-sharing plan (currently being contested by certain stockholders in the courts) provides that every person in the organization from top to bottom who has owned common stock and has been employed for not less than a year is entitled to a share, in proportion to his holdings of stock, in 10% of net earnings over and above a fixed amount of $2,219,000. It is for this reason that the common stock commands a premium over the Class "B" stock, approximately 2,000 officers and employees having received (in addition to regular dividends) per share distributions on the common stock amounting in recent years to: $2.07 in 1944, $2.29 in 1943, and $2.45 in 1942.



OUTLOOK

It has already been pointed out that R. J. Reynolds enjoys a continuity of management dating right back to the founding of the company in 1875. The management, concentrated in Winston-Salem, has for the most part grown up in, lived with and literally breathed the tobacco business in Winston-Salem's aromatic atmosphere. A closely knit enterprise this, a business family if you like, the company has long been in the forefront in introducing not only new methods of operation (belt conveyor systems in 1912, air-conditioning as early as 1915, cellophane wrappers), but also policies and methods to promote welfare of employees (profit-sharing plan in 1912; hospital care including families; insurance and retirement benefits; and low cost cafeteria service).

The management is very proud of the record of the company and has every confidence in the early and longer-range outlook for the cigarette industry in general and for R. J. Reynolds Tobacco Co. in particular. Because a large quantity of modern machinery had been installed just before priorities intervened and sufficient replacement parts have been obtained to maintain the entire plant in efficient working condition throughout the war, reconversion problems seem negligible, although some replenishment of machinery will be necessary as soon as it is obtainable.

Production could be stepped up about 25% over 1944 with existing equipment were the tobacco available. The company has been cutting down on advertising expenses for around two years but believes that the present advertising outlay is adequate to insure maintenance of the position of CAMEL Cigarettes when the merchandising of cigarettes becomes again a sales promotion job. It seems reasonable to conclude that there will be little, if any, recession from present high consumption of cigarettes and that cigarette consumption may continue its growth after the war, given a satisfactory level of purchasing power. In addition, insufficient tobacco, manpower shortages and price controls seem temporary earnings deterrents.

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